

Message Text

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PM-07 RSC-01 SAM-01 SCI-06 SP-03 SS-20 STR-08 FEA-02

IO-14 FRB-02 /220 R

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FM SECSTATE WASHDC

TO AMEMBASSY ABU DHABI

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY CARACAS

AMEMBASSY THE HAGUE

AMEMBASSY JAKARTA

AMEMBASSY JIDDA

AMEMBASSY KUWAIT

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AMEMBASSY STOCKHOLM

AMEMBASSY TEHRAN

AMEMBASSY TOKYO

AMEMBASSY CAIRO

USINT ALGIERS

USINT BAGHDAD

AMEMBASSY TRIPOLI

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KUWAIT PASS DOHA, CAIRO PASS BENNETT

E.O. 11652: N/A

IN VIEW OF WIDESPREAD INTEREST IN JULY 9, 1974
TESTIMONY BY UNDER SECRETARY OF THE TREASURY FOR
MONETARY AFFAIRS JACK F. BENNETT TO SUBCOMMITTEE ON
INTERNATIONAL FINANCE OF HOUSE BANKING AND CURRENCY
COMMITTEE, DEALING WITH IMPACT OF OIL DEVELOPMENTS,
FULL TEXT OF STATEMENT IS REPRODUCED BELOW FOR POSTS USE.

IN DRAFT THIS STATEMENT CONTAINED SENTENCE READING AS
FOLLOWS: "IN MY VIEW, ANY NEW CUTBACKS IN OIL PRODUCTION
BY ANY GOVERNMENT AT THIS TIME SHOULD CLEARLY BE REGARDED
BY THE UNITED STATES AND BY ALL OTHER CONSUMING COUNTRIES,
BOTH MORE-DEVELOPED AND LESS-DEVELOPED, AS AN UNFRIENDLY
ACT." PRIOR TO DELIVERY AND OFFICIAL RELEASE, PHRASE
"UNFRIENDLY ACT" WAS DELETED AND WORDS "COUNTER-PRODUCTIVE
MEASURE" SUBSTITUTED IN ORDER TO AVOID ANY POSSIBLE
MISUNDERSTANDING AS RESULT OF THE CONNOTATION SOMETIMES
GIVEN TO WORDS "UNFRIENDLY ACT" IN DIPLOMATIC EXCHANGE.
UNFORTUNATELY, NEWS SERVICES BECAME AWARE OF EARLIER
PHRASING AND HIGHLIGHTED THE MODIFICATION. IT SHOULD
BE UNDERSTOOD, HOWEVER, THAT PHRASE "UNFRIENDLY ACT" WAS NOT
REPEAT NOT INCLUDED IN APPROVED TEXT OR USED IN DELIVERY TO
SUBCOMMITTEE.

BEGIN TEXT:

THE HEARINGS YOU HAVE SCHEDULED FOR THIS MORNING ARE
PARTICULARLY OPPORTUNE FOR ME. AT NOON TODAY, I AM
SCHEDULED TO HAVE THE HONOR OF BEING SWORN IN AS PAUL
VLOCKER'S SUCCESSOR AS UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS. AT ANY TIME THAT WOULD BE A CHALLENG-
ING ASSIGNMENT, BUT IT HASN'T ESCAPED MY ATTENTION, ANY MORE
THAN IT HAS YOURS, THAT CONDITIONS TODAY IN FOREIGN EXCHANGE
AND FINANCIAL MARKETS AND RATES OF GROWTH IN PRICES AND
ECONOMIC PRODUCTION ARE FAR FROM SATISFACTORY AROUND THE
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WORLD. UNDER THE CIRCUMSTANCES, IT SEEMS FITTING THAT I BE
SUBJECTED TO SOME PUBLIC CROSS-EXAMINATION OF MY THINKING AS
I ENTER INTO THE NEW DUTIES. I AM PAINFULLY AWARE, HOWEVER,
THAT THE OATH TO BE ADMINISTERED LATER TODAY BY SECRETARY
SIMON WILL NOT MAKE ME AN INSTANT EXPERT ON ALL ECONOMIC
SUBJECTS.

IN TRYING TO UNDERSTAND OUR PRESENT DIFFICULTIES, I
THINK PRIMARY ATTENTION MUST BE GIVEN TO TWO MAJOR DEVELOP-
MENTS OF THE LAST SEVERAL YEARS:

FIRST, THE SHORTFALLS AND CUTBACKS IN
PREVIOUSLY ANTICIPATED LEVELS OF PRODUCTION OF
IMPORTANT BASIC RAW MATERIALS, MOST IMPORTANTLY OIL; AND

SECOND A WIDESPREAD TENDENCY FOR GOVERNMENTS TO PRINT MORE MONEY AND MORE GOVERNMENT IOU'S THAN WERE APPROPRIATE IN SUCH CONDITIONS OF SUPPLY STRINGENCY.

IN MY PREPARED STATEMENT THIS MORNING, I PROPOSE TO CONCENTRATE ON THE FIRST OF THESE DEVELOPMENTS, AND PARTICULARLY ON THE IMPACT OF THE REDUCTION IN ANTICIPATED LEVELS OF OIL PRODUCTION. THAT IMPACT CONTINUES TO BE LARGE, AND OUR DIFFICULTIES ARE EXACERBATED BY THE UNCERTAINTY AS TO JUST HOW LARGE THE CUTBACK WILL BE IN THE FUTURE.

LAST SEPTEMBER, BEFORE THE OUTBREAK OF FIGHTING IN THE MIDEAST, PRODUCTION OF OIL IN THE NON-COMMUNIST WORLD WAS JUST SHORT OF 48 MILLION BARRELS A DAY. BY NOVEMBER, CERTAIN GOVERNMENTS IN AFRICA AND THE MIDEAST HAD CUT PRODUCTION BACK BY ABOUT 5 MILLION BARRELS A DAY. THIS LARGE CUTBACK WAS FOLLOWED QUICKLY BY A LARGE INCREASE IN PRICES ON NEW SHORT-TERM OIL SALES. EVEN NOW, SOME OF THE PRODUCING COUNTRIES ARE CONTINUING TO CUT BACK PRODUCTION FAR BELOW THE LEVELS OF LAST SEPTEMBER; BUT ELSEWHERE PRODUCTION HAS GROWN SO THAT TOTAL WORLD PRODUCTION IS PROBABLY NOW ABOUT AT LAST SEPTEMBER'S LEVEL -- WITHIN TWO OR THREE HUNDRED THOUSANDS BARRELS PER DAY, ONE WAY OR THE OTHER. BUT IT IS IMPORTANT TO NOTE THAT THAT LEVEL OF ACTUAL PRODUCTION TODAY STILL REFLECTS RESTRAINTS BY CERTAIN GOVERNMENTS WHICH

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ARE HOLDING TOTAL PRODUCTION ROUGHLY 4 MILLION BARRELS A DAY BELOW THE LEVEL WHICH COULD BE PRODUCED EFFICIENTLY WITH EXISTING CAPACITY IN PLACE.

NEW CONTRACT OIL SALE PRICES HAVE FALLEN FROM THE TEMPORARY PEAKS OF EARLY THIS YEAR, BUT SOME OIL PRODUCERS ARE STILL ATTEMPTING TO CHARGE EXTRAORDINARILY HIGH PRICES. IN VIEW OF THESE HIGH PRICES, CONSUMERS BOTH IN THE U.S. AND ELSEWHERE HAVE CONTINUED TO HOLD THEIR CONSUMPTION WELL BELOW LEVELS PREDICTED EARLIER. IN FACT, ON A WORLDWIDE BASIS CONSUMPTION HAS BEEN LESS THAN PRODUCTION FOR SOME TIME NOW. INVENTORIES HAVE BEEN BUILDING UP AND ARE NOW APPROACHING THE SPILL-OVER POINT.

UNDER THESE CIRCUMSTANCES, CRUDE OIL PRICES TODAY CLEARLY ARE UNDER STRONG PRESSURE TO DECLINE FURTHER ON INTERNATIONAL MARKETS -- THOUGH NOT ON THE BULK OF U.S. PRODUCTION, WHICH IS UNDER SEVERE PRICE CONTROL. YET, THERE ARE THOSE IN THE PRODUCING COUNTRIES WHO ARE URGING THEIR GOVERNMENTS TO MAKE NEW SHARP CUTBACKS IN PRODUCTION IN ORDER TO TRY TO MAINTAIN TODAY'S HIGH OIL PRICES, OR EVEN TO TRY TO INCREASE THEM AGAIN. THE PRODUCING GOVERNMENTS ARE BEING URGED TO RAISE PRICES ON THAT PORTION OF THE OIL PRO-

DUCTION BEING SOLD DIRECTLY BY THE GOVERNMENTS AND TO RENEGE ON LONG-TERM CONTRACTS TO MAKE SOME OIL AVAILABLE ON THE BASIS OF AGREED SPECIFIED PAYMENTS OF ROYALTIES AND TAXES TO THE GOVERNMENTS.

IN MY VIEW, ANY NEW CUTBACKS IN OIL PRODUCTION BY ANY GOVERNMENT AT THIS TIME SHOULD CLEARLY BE REGARDED BY THE UNITED STATES AND BY ALL OTHER CONSUMING COUNTRIES, BOTH MORE-DEVELOPED AND LESS-DEVELOPED, AS A COUNTER-PRODUCTIVE MEASURE. MOREOVER, EVEN APART FROM THE POLITICAL AND SECURITY IMPLICATIONS FOR THE PRODUCERS, I AM CONVINCED THAT ANY SUCH CUT BACKS WOULD TURN OUT TO ECONOMICALLY HARMFUL TO THE PRODUCERS FOR TWO REASONS. IN THE FIRST PLACE, THE PRICE EFFECTS OF SUCH CUTBACKS WOULD INEVITABLY LEAD TO SUCH FURTHER INTENSIFICATION OF RESEARCH AND INVESTMENT RELATING TO ALTERNATIVE SOURCES OF ENERGY AND TO ALTERNATIVES TO ENERGY USE THAT THE EFFECT WOULD BE TO REDUCE THE TOTAL VALUE WHICH THE EXPORTERS WOULD RECEIVE FOR THEIR OIL OVER THE LIFE OF THEIR PRODUCING FIELDS. CUTBACKS MIGHT BRING A HIGHER

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PRICE FOR A SHORT PERIOD, BUT THEY WULD BRING A MORE THAN OFFSETTING REDUCTION IN REVENUES FOR A LONG TIME THEREAFTER -- IN VIEW OF IMPORTERS' INCREASED COMMITMENT TO ALTERNATIVES.

IN THE SECOND PLACE, MAINTENANCE OF PRESENT COSTS OF EXPORT OIL --EVEN WITH NO INCREASES -- WOULD THREATEN SEVERE ECONOMIC -- AND, IN SOME CASES, POLITICAL -- DAMAGE TO A LARGE NUMBER OF CONSUMING COUNTRIES TO AN EXTENT WHICH COULD NOT HELP BUT CAUSE DAMAGING BACKLASH ON THE PRODUCERS AS WELL.

THE DAMAGE TO THE CONSUMING COUNTRIES IN THE FIRST INSTANCE WOULD BE SIMPLE BUT REAL -- THE RESULT OF AN INCREASE IN THE COSTS OF THEIR OIL IMPORTS FAR GREATER THAN THE INCREASE IN THE PRICES OF THEIR EXPORTS. IN THIS REGARD, I REALIZE THAT SOME OFFICIALS OF OIL-PRODUCING COUNTRIES HAVE ATTEMPTED TO JUSTIFY FURTHER OIL PRICE INCREASES BY REFERENCE TO INCREASES IN THE PRICES OF GOODS IMPORTED INTO THOSE COUNTRIES. PROVIDING THE PRODUCERS WITH THIS ARGUMENT HAS UNDOUBTEDLY BEEN ONE ADDITIONAL DAMAGE WE IN THE DEVELOPED NATIONS HAVE INFLICTED ON OURSELVES BY OUR MISERABLE PERFORMANCE IN RELATION TO INFLATION. BUT WE SHOULD NOT LOSE OUR SENSE OF PROPORTION. SINCE 1970, FOR EXAMPLE, THE NEW CONTRACT FOB EXPORT DOLLAR PRICE OF SAUDI ARABIAN LIGHT CRUDE HAS INCREASED APPROXIMATELY 730 PERCENT, WHEREAS THE AVERAGE COST OF IMPORTED GOODS AND SERVICES INTO THE PRODUCING COUNTRIES HAS INCREASED ONLY ABOUT 70 PER CENT OVER THE SAME PERIOD. CLEARLY, THE INCREASE IN OIL PRICES HAS BEEN ABOUT 10 TIMES AS LARGE. ON A SIMILAR CALCULATION, THE OIL PRICE INCREASE HAS BEEN ABOUT 7 TIMES AS LARGE FROM 1960 TO THE PRESENT.

THE LARGE AND SUDDEN ADVERSE CHANGE IN THEIR TERMS OF TRADE FINDS DIFFERENT NATIONS WITH WIDELY VARYING CAPABILITIES TO ADAPT. FOR MOST IMPORTING NATIONS, INCLUDING THE UNITED STATES, THE IMPACT IS REDUCING OUR STANDARD OF LIVING AND IS REDUCING OUR RATE OF ECONOMIC GROWTH, BUT OUR LIVES AND OUR INSTITUTIONS ARE NOT SERIOUSLY THREATENED. IN A NUMBER OF OTHER NATIONS, HOWEVER, NATIONS WHOSE STANDARDS OF LIVING WERE ALREADY AT THE LITERAL MARGIN, AND WHOSE HOPES FOR ECONOMIC ADVANCEMENT WERE FRAGILE IN ANY CASE, THE

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SUDDEN INCREASE IN THE COSTS OF OIL -- AND, CONSEQUENTLY, OF FERTILIZER AS WELL -- COULD BE CASTASTROPIC UNLESS THERE IS EMERGENCY ASSISTANCE. AND EVEN IN SOME COUNTRIES WHOSE STANDARDS OF LIVING ARE FAR ABOVE THE SUBSISTENCE LEVEL THE NEW PRICES COULD -- IN THE ABSENCE OF FAR-SIGHTED INTERNATIONAL COOPERATION-- THREATEN THE COLLAPSE OF EXISTING INSTITUTIONS.

SUCH SEVERE DAMAGE TO THE CONSUMING COUNTRIES WOULD CREATE A BACKLASH ON THE PRODUCERS -- APART FROM POLITICAL DANGERS -- THROUGH UNDERMINING THE ECONOMIES TO WHICH THE OIL PRODUCERS MUST EXPORT IF THEY ARE TO DERIVE THE MAXIMUM VALUE FROM THEIR LIMITED RESOURCES; AND THROUGH UNDERMINING THE ECONOMIES IN WHICH THE OIL PRODUCERS MUST TEMPORILY INVEST IF THEY ARE TO SELL THEIR OIL AT THE MOST REWARDING TIME AND SPEND THE PROCEEDS ON EQUIPMENT AND SERVICES FOR THEIR OWN DIVERSIFIED DEVELOPMENT AT THE OPITMAL, NON-WASTEFUL PACE.

YOU WILL HAVE OBSERVED THAT, IN DISCUSSING THESE IMPLICATIONS OF ACTUAL AND POTENTIAL OIL PRODUCTION CUTBACKS, I HAVE STRESSED THE UNDERLYING AND REAL ECONOMIC EFFECTS. I DO THIS BECAUSE I BELIEVE THEY ARE SERIOUS -- AND BECAUSE I THINK THE WORLD SHOULD BE AWARE OF THE CONTRAST BETWEEN THE DELIBERATE CUTBACKS BY SOME OIL PRODUCERS, ON THE ONE HAND, AND THE DETERMINED EFFORTS BEING MADE, ON THE OTHER HAND, BY THE UNITED STATES AND OTHER NATIONS TO INCREASE TO THE MAXIMUM THEIR PRODUCTION OF AGRICULTURAL AND OTHER COMMODITIES TO SUPPLY WORLD MARKETS.

WHILE I STRESS THESE BASIC EFFECTS, I DO NOT WISH TO IGNORE THE IMPACTS OF THE OIL CUTBACKS ON THE FINANCIAL INSTITUTIONS AND ARRANGEMENTS OF THE FREE WORLD. THE INDIRECT EFFECTS HAVE BEEN SERIOUS AND WELL PUBLICIZED FOR A SMALL NUMBER OF BANKS, FOR EXAMPLE. YET, IN MY JUDGMENT, OUR FINANCIAL INSTITUTIONS AND INTERNATIONAL MONETARY ARRANGEMENTS ARE NOT LIKELY TO BE BASICALLY THREATENED BY THESE DEVELOPMENTS IN THE COMMODITY FIELD. CURRENT PROBLEMS ARE REAL FOR SOME INDIVIDUALS, FOR PARTICULAR COMPANIES, AND FOR ENTIRE COUNTRIES, BUT THEY ARE THE PROBLEMS OF REDUCED SUPPLY OF GOODS; THEY ARE NOT LIKELY TO BE INTENSIFIED BY FAILURE OF OUR

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INSTRUMENTS OF FINANCIAL COOPERATION.

NEITHER DO I FEEL THAT CURRENT DEVELOPMENTS POSE A SERIOUS THREAT OF WORLD DEPRESSION. THOSE WHO CONCENTRATE THEIR WORRYING TODAY ON THE POSSIBILITY OF WORLD DEPRESSION HAVE BROUGHT TO MY MIND THE PICTURE OF A MAN IMMOBILIZED IN THE FACE OF A CHARGING BULL BY THE FEAR THAT IF HE TRIED TO ESCAPE THE ANIMAL BY JUMPING SIDEWAYS HE MIGHT POSSIBLY BRUSH UP AGAINST AN UNSEEN RATTLESNAKE. CERTAINLY, RATTLESNAKES -- AND ALSO INADEQUATE DEMAND FOR OUR ECONOMIC PRODUCTION -- ARE ALWAYS CONCEIVABLE DANGERS; BUT, RIGHT NOW, THE CLEAR AND PRESENT DANGER BEFORE US IS NOT INADEQUATE DEMAND BUT FAR TOO MUCH MONETARY DEMAND FACING EXISTING CAPACITY TO PRODUCE. EFFORTS TO DRAW A PARALLEL BETWEEN TODAY'S CIRCUMSTANCES AND THE EARLY THIRTIES SEEM TO ME FAR FETCHED. THE PROBLEM THEN WAS TOO LITTLE DEMAND FACING LARGE AMOUNTS OF UNUSED CAPACITY.

THE DEVELOPMENTS IN THE COMMODITY MARKETS HAVE, OF COURSE, BEEN RESULTING IN LARGE CHANGES IN PREVIOUS PATTERNS OF FINANCIAL FLOWS. CONSUMERS AND CONSUMING NATIONS ARE CHOOSING TO BORROW A LOT MORE THAN BEFORE IN ORDER TO EASE THEIR TRANSITION TO A WORLD OF HIGHER COST ENERGY. AND SOME OF THE OIL PRODUCERS ARE CHOOSING TO EXPORT A LARGE PART OF THEIR OIL IN EXCHANGE FOR IOU'S FROM THE CONSUMING COUNTRIES.

THERE HAVE BEEN VARIOUS ESTIMATES THAT THE OIL-PRODUCING COUNTRIES IN COMBINATION WILL INCREASE THEIR INVESTMENTS ABROAD BY \$50 TO \$60 BILLION DURING THIS YEAR. I DON'T PLACE CONFIDENCE IN ANY PRECISE ESTIMATE, FOR IT IS NOW UNCLEAR, NOT ONLY WHAT THE PRICE OF OIL WILL BE DURING THE REST OF THIS YEAR, BUT EVEN WHAT IT WAS FOR THE FIRST HALF OF THE YEAR, SINCE VARIOUS NEGOTIATIONS ON THAT SUBJECT ARE STILL UNDER WAY. FURTHERMORE, AT ANY PARTICULAR PRICE, IT IS UNCLEAR HOW MUCH OIL ANY INDIVIDUAL CONSUMING COUNTRY WILL CHOOSE TO BUY, TO WHAT EXTENT IT WILL CHOOSE TO RUN CURRENT ACCOUNT DEFICITS BY LIGHTENING ITS CURRENT ECONOMIC BURDENS THROUGH BORROWING AND BURDENING ITS FUTURE WITH REPAYMENT OBLIGATIONS. ITALY AND FRANCE, FOR EXAMPLE, HAVE RECENTLY TAKEN FORCEFUL DOMESTIC MEASURES TO REDUCE THEIR OIL

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CONSUMPTION AND THEIR RELIANCE ON OIL IMPORTS, AND MANY OTHER NATIONS WILL PROBABLY TAKE STEPS IN THAT SAME DIRECTION.

FORECASTS OF THE RATE OF FURTHER ACCUMULATION OF FOREIGN INVESTMENTS BY THE OIL-PRODUCING COUNTRIES IN FUTURE YEARS ARE

EVEN MORE TENUOUS. MY OWN EXPECTATION, HOWEVER, IS THAT THE RATE WILL DECLINE EACH YEAR, NOT ONLY BECAUSE OF LOWER OIL PRICES I ANTICIPATE, BUT ALSO BECAUSE OVER TIME THE DEVELOPMENT PLANS OF THE PRODUCERS WILL HAVE PROGRESSED SO THAT THEY ARE USING UP INCREASING PROPORTIONS OF CURRENT REVENUES. IT HAS BEEN ESTIMATED THAT THIS YEAR OIL EXPORTERS WILL BE SPENDING AROUND 40 PERCENT OF THEIR RECEIPTS FOR CURRENT IMPORTS; I WOULD EXPECT THIS PERCENTAGE TO BE MUCH LARGER IN FUTURE YEARS -- AND, ULTIMATELY, IT WILL EXCEED 100 PERCENT.

MEANWHILE, HOWEVER, THE OIL PRODUCERS HAVE BEEN ACCUMULATING WHAT, BY ANY STANDARDS, ARE LARGE INVESTMENTS. BY NOW, THEY QUITE PROBABLY EXCEED \$30 BILLION; AND IN THE EARLY MONTHS OF THIS YEAR THE ACCRETIONS WERE BEING LARGELY PLACED IN SHORT-TERM BANK DEPOSITS CONCENTRATED IN THE FOREIGN BRANCHES AND FOREIGN CURRENCY ACCOUNTS WHICH COMPRISE THE SO-CALLED EURO-MARKET. THIS CONCENTRATION HAD BEGUN TO RAISE QUESTIONS ABOUT CAPITAL ADEQUACY IN THE BANKS AND ABOUT THEIR VULNERABILITY TO SUDDEN LARGE WITHDRAWALS. MORE RECENTLY, STRONG COUNTER-PRESSURES HAVE BEGUN TO EXERT THEMSELVES. THE BANKS HAVE BEGUN TO REJECT ADDITIONAL SHORT-TERMS DEPOSITS AND TO INSIST ON TERMS MORE IN LINE WITH THE RELENDING OPPORTUNITIES AVAILABLE TO THEM. THE OIL-PRODUCING COUNTRIES, THEMSELVES, AND OTHER DEPOSITORS, HAVE BECOME MORE CAREFUL TO INSURE THEY WERE NOT RISKING THEIR FUNDS IN INSTITUTIONS WITH AN INADEQUATE CAPITAL BASE. AND THERE HAS ACCORDINGLY BEEN INCREASED INTEREST IN INVESTING IN U.S. TREASURY SECURITIES AND IN OTHER LONGER TERM SECURITIES, INCLUDING U.S. CORPORATE EQUITIES. SECRETARY SIMON AND I HOPE TO DISCUSS THESE POSSIBILITIES DURING OUR TRIP TO THE MIDEAST STARTING THURSDAY. I SUSPECT THE TIME MAY ALSO BE COMING WHEN THERE WILL BE INCREASED INTEREST BOTH BY FOREIGN AND DOMESTIC INVESTORS IN OFFERING NEW EQUITY FOR SELECTED PRIVATE BANKS. WITH THE EXPANDED BANKING BUSINESS TO BE HAD, THERE WILL BE THOSE WHO WISH TO TAKE ADVANTAGE OF THE PROFITABLE INVESTMENT OPPORTUNITIES WHICH SHOULD EXIST. OBVIOUSLY, NEW EQUITY IS THE ANSWER IF BANKS

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HAVE MORE BUSINESS THAN THEY CAN HANDLE WITH THEIR EXISTING EQUITY BASE.

SECRETARY SIMON, IN HIS RECENT SPEECH TO THE INTERNATIONAL MONETARY CONFERENCE IN WILLIAMSBURG, ALSO RECOGNIZED A GOVERNMENTAL RESPONSIBILITY IN THIS AREA. WHILE NOTING THAT "GOVERNMENT REGULATION AND EMERGENCY FACILITIES CAN NEVER SUBSTITUTE FOR PRUDENT FINANCIAL MANAGEMENT", HE NONETHELESS EMPHASIZED THAT "IN THE UNITED STATES, IT IS CLEAR THAT THE AUTHORITIES DO HAVE A RESPONSIBILITY TO SUPERVISE U.S. BANKS IN BOTH THEIR DOMESTIC AND INTERNATIONAL OPERATIONS, AND A MAJOR PART OF THAT RESPONSIBILITIES IS TO INSURE THAT THEY ARE IN A SOUND POSITION TO MEET THEIR TOTAL LIABILITIES."

ALL THE RECENT ATTENTION TO POSSIBLE MASSIVE WITHDRAWAL OF FUNDS SHOULD NOT LEAD ANYONE TO CONCLUDE THAT THE OIL-PRODUCING COUNTRIES HAVE BEEN SHIFTING THEIR FUNDS ABOUT IN A VOLATILE MANNER. IN FACT, THEIR OFFICIALS HAVE SHOWN THEMSELVES TO BE VERY CONSERVATIVE INVESTMENT MANAGERS, WELL AWARE OF THE LOSS IN THE VALUE OF THEIR INVESTMENTS WHICH WOULD RESULT FROM ANY SUDDEN EFFORT TO UNLOAD A LARGE AMOUNT OF THEIR SECURITIES ON THE CAPITAL MARKET OR TO TRANSFER A LARGE AMOUNT OF THEIR FUNDS FROM ONE CURRENCY TO ANOTHER.

IN RELATION TO THE FOREIGN EXCHANGE MARKETS, THE SITUATION MUST BE MONITORED CAREFULLY, BUT IT SHOULD BE RECOGNIZED THAT ANY INSTABILITY WHICH MAY HAVE BEEN CAUSED BY THE LARGE HOLDINGS OF THE OIL PRODUCERS ARE LIKELY TO HAVE ARISEN NOT FROM SUDDEN SHIFTS OF THESE FUNDS FROM ONE INVESTMENT TO ANOTHER BUT RATHER FROM SWINGS IN MARKET EXPECTATIONS AS TO WHERE THEIR NEW ACCRETIONS OF FUNDS WOULD BE INVESTED.

IN VIEW OF THE UNCERTAINTY ON THIS SUBJECT, IT IS FORTUNATE THAT BEFORE THE QUESTION AROSE THERE HAD ALREADY BEEN SO MUCH PROGRESS TOWARD GREATER FLEXIBILITY IN OUR INTERNATIONAL MONETARY ARRANGEMENTS. IN THIS PERIOD OF CHANGE IN TRADE AND INVESTMENT PATTERNS, AND IN THE PRESENCE OF WIDELY DIFFERING RATES OF INFLATION IN DIFFERENT COUNTRIES, AN ATTEMPT TO MAINTAIN A FRAMEWORK OF RIGID EXCHANGE RATES WOULD PROBABLY HAVE LED, IN PRACTICE, TO EXPLOSIVE INSTABILITY. THERE HAVE BEEN SUBSTANTIAL CHANGES IN EXCHANGE RATES SINCE THE UPWARD SPURT

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OF OIL PRICES BEGAN LAST OCTOBER. YET, THESE HAVE BEEN HANDLED WITHOUT SERIOUS INTERRUPTION TO THE WORLD'S TRADE AND INVESTMENT TRANSACTIONS. A SMALL NUMBER OF BANKS DID GET INTO TROUBLE IN THEIR FOREIGN EXCHANGE DEALING DURING THIS PERIOD, BUT THEIR DIFFICULTIES SEEM TO HAVE BEEN FOCUSED IN FAULTY INTERNAL PROCEDURES AND IN INVOLVEMENT IN FOREIGN EXCHANGE SPECULATION OUT OF PROPORTION TO THE SIZE OF THE INSTITUTIONS. REGRETTABLE AS THEIR EXPERIENCE WAS, IT PROBABLY HAS HAD THE SALUTARY EFFECT OF BRINGING OTHER INSTITUTIONS TO EXAMINE THEIR FOREIGN EXCHANGE PRACTICES MORE CAREFULLY. AND THE RECENT HERSTATT CASE IN GERMANY, IN PARTICULAR, IS LEADING BANKS TO CONSIDER WHETHER CHANGES ARE DESIRABLE IN INTERBANK CLEARING PROCEDURES TO REDUCE UNINTENDED RISK EXPOSURE IN WHAT WERE INTENDED TO BE ESSENTIALLY RISKLESS SIMULTANEOUS TRANSACTIONS.

IN RECENT WEEKS, THE U S AND OTHER GOVERNMENTS HAVE ALSO GIVEN CONSIDERATION TO THE POSSIBILITY OF SETTING UP A NEW INTER-GOVERNMENTAL AGENCY WHICH WOULD BE DESIGNED TO BORROW LARGE AMOUNTS OF MONEY FROM THE OIL PRODUCERS ON COMMERCIAL TERMS AND THEN TO RE-LEND THOSE FUNDS IN OTHER COUNTRIES AGAIN ON COMMERCIAL TERMS. THAT TYPE OF AGENCY REMAINS A POSSIBILITY, IF IT SHOULD BE NEEDED, BUT AT THE MOMENT THE CONSENSUS--WHICH I THINK IS WISE--IS THAT IT

WOULD BE BETTER TO RELY BASICALLY ON THE MANY DIFFERENT CHANNELS PROVIDED BY EXISTING INSTITUTIONS FOR HANDLING THE LARGE, NEW INVESTMENT FLOWS AMONG NATIONS.

GOVERNMENTS, NONETHELESS, HAVE AN IMPORTANT SUPPORTIVE ROLE. IN THE U.S., WE RECOGNIZED THAT EARLIER THIS YEAR BY REMOVING THE CONTROLS ON THE OUTFLOW OF CAPITAL FROM THE UNITED STATES. WE RECOGNIZED IT BY EXPANDING THE NETWORK OF BILATERAL SWAP AGREEMENTS BY WHICH GOVERNMENTS STAND READY TO HELP EACH OTHER IN CASE OF SHORT-RUN EXCHANGE MARKET DISTURBANCES. AND WE AND OTHER GOVERNMENTS RECOGNIZED IT BY A WIDE RANGE OF COOPERATIVE INTERNATIONAL INITIATIVES. AT THE RECENT FINAL MEETING OF THE "C-20" MINISTERIAL COMMITTEE, THERE WAS A RENEWED DEDICATION TO INTERNATIONAL MONETARY COOPERATION AND AGREEMENT ON A NEW PLEDGE TO AVOID RESTRICTIVE TRADE MEASURES FOR BALANCE OF PAYMENTS PURPOSES. A NEW FACILITY WAS CREATED IN THE IMF TO PROVIDE 4-TO 7-YEAR CREDIT ASSISTANCE TO AID NATIONS IN ADJUSTING TO HIGHER OIL PRICES, AND THERE WAS UNCLASSIFIED

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AGREEMENT THAT IN SOME CASES--THROUGH A SO-CALLED EXTENDED FUND FACILITY--THE IMF SHOULD BE ABLE IN SPECIAL CASES TO PROVIDE CREDIT OF LONGER MATURITY TO LESS-DEVELOPED COUNTRIES UNDERGOING MAJOR STRUCTURAL CHANGES. THERE IS ALSO AN UNDERSTANDING THAT GOVERNMENTS IN NEED MAY SELL SOME PORTION OF THEIR GOLD HOLDINGS INTO PRIVATE MARKETS OR USE THEIR GOLD AS COLLATERAL FOR BORROWING.

ALL THESE ACTIONS WERE CONSTRUCTIVE RESPONSES WHICH HAVE STRENGTHENED OUR INTERNATIONAL MONETARY SYSTEM. BUT WE MUST RECOGNIZE THAT FOR A SMALL NUMBER OF PARTICULARLY HARD HIT COUNTRIES THESE MEASURES ARE NOT LIKELY TO BE ENOUGH. I'M SURE THAT JIM GRANT WILL LATER THIS MORNING BE MORE ELOQUENT THAN I CAN BE ON THE PROSPECTIVE PLIGHT OF THOSE COUNTRIES WHOSE STANDARDS OF LIFE WERE ALREADY ABYSMALLY LOW AND NOW HAVE THE DISTINCTION OF BEING THE "MOST SERIOUSLY AFFECTED" BY THE NEW OIL PRICES. THESE ARE AMONG THE COUNTRIES WHICH HAVE REASON TO BE GRATEFUL TO YOU ON THIS SUBCOMMITTEE FOR SECURING PASSAGE OF THE IDA AUTHORIZATION A FEW DAYS AGO. YET THOSE FUNDS WERE INTENTIONALLY CLEARLY EARMARKED TO BE USED ON SPECIFIC LONG-RANGE DEVELOPMENT PROJECTS TO RAISE THEIR PEOPLE FROM THE SINK OF POVERTY. THOSE IDA FUNDS WILL NOT BE, AND SHOULD NOT BE, AVAILABLE TO HELP PAY ANY OF THE TREMENDOUS INCREASE IN THE COSTS OF OIL AND FERTILIZER FOR THE IMMEDIATE USE OF THEIR STRUGGLING ECONOMIES. FOR THIS PURPOSE, THESE COUNTRIES WILL BE PLEADING, BEFORE THIS YEAR IS OVER, FOR SOME NON-PROJECT FUNDS ON A CONCESSIONAL BASIS. THERE IS NO LIKELIHOOD, HOWEVER, THAT SUCH FUNDS COULD BE REPAID WITHIN A FEW YEARS; THEY WILL HAVE TO BE ON A LONG-TERM, LOW-INTEREST BASIS. IN MOST CASES, THE LACK OF THESE FUNDS IS PROBABLY NOT A MATTER OF LIFE AND DEATH THIS WEEK, BUT THAT TIME IS PROBABLY NOT MAY MONTHS AWAY. AND THE TOTAL SUMS IN QUESTION FOR THIS

YEAR ARE NOT IMMENSE. I DOUBT THAT IT WILL ULTIMATELY BE DECIDED THAT A LARGE AMOUNT IS APPROPRIATE IN THIS CALENDAR YEAR FROM ALL SOURCES IN NEW FORMS OF AID ABOVE THOSE TRADITIONAL FORMS OF AID ALREADY SCHEDULED.

STILL, THERE IS AN ORGANIZATIONAL URGENCY IN REACHING A CONSENSUS ON SOME ANALYSIS OF THE FACTUAL SITUATION IN THESE COUNTRIES AND IN INSURING THAT THERE IS AN ADEQUATE RESPONSE FROM THOSE COUNTRIES OF THE WORLD WHO ARE IN A MORE-FAVORED UNCLASSIFIED

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POSITION.

SOME OF THE OIL-PRODUCING COUNTRIES HAVE BEGUN TO RESPOND WITH ISOLATED BILATERAL ARRANGEMENTS. THERE HAVE ALSO BEEN APPEALS FOR FUNDS BY THE UN AND DISCUSSIONS OF VARIOUS POSSIBLE JOINT INITIATIVES BY SOME OF THE OIL EXPORTERS, BUT LITTLE HAS ACTUALLY BEEN COMMITTED AT THIS TIME SPECIFICALLY TO ALLEVIATE THE NEAR-TERM DISTRESS OF THE "MOST SERIOUSLY AFFECTED".

THE OIL PRODUCERS HAVE AGREED TO PURCHASE ADDITIONAL AMOUNTS OF WORLD BANK BONDS AND TO LEND ABOUT \$3 BILLION TO THE IMF, BUT THESE INVESTMENTS ARE AT APPROXIMATELY MARKET TERMS AND ARE EFFECTIVELY GUARANTEED AS TO REPAYMENT BY THE MAJOR DEVELOPED NATIONS, INCLUDING THE U.S. THEY DO NOT REPRESENT PROVISION OF THE CONCESSIONAL FUNDS APPROPRIATE FOR THE "MOST SERIOUSLY AFFECTED".

FOR THEM, THE RESCUE OPERATION, IN LARGE PART, REMAINS TO BE ORGANIZED. FOR THIS PURPOSE, IT MAY WELL BE THAT NO NEW FINANCIAL INSTITUTION IS NEEDED; BUT THERE MUST BE A GROUP WHICH IS CHARGED WITH BEING SURE THE JOB GETS DONE. FOR THIS PURPOSE, I AM PLACING GREAT HOPE ON THE NEW MINISTERIAL DEVELOPMENT COUNCIL TO BE SET UP ALONG C-20 LINES, IN ACCORDANCE WITH A DECISION TAKEN BY THE MINISTERS WHEN THEY WERE IN WASHINGTON LAST MONTH FOR THE FINAL C-20 MEETING. I CERTAINLY HOPE THAT THIS NEW GROUP REPRESENTING OIL PRODUCERS AND OIL CONSUMERS, BOTH DEVELOPED AND LESS DEVELOPED, WILL BE SMALL ENOUGH TO FUNCTION EFFECTIVELY AND WILL HAVE THE COMPETENCE AND THE CONSCIENCE FOR THE JOB.

THE PROBLEMS WHICH THAT NEW COUNCIL WILL FACE AND THE PROBLEMS WHICH ALL OF US FACE WITH THE NEW OIL PRICES ARE REAL. THE APPROPRIATE REMEDY IS TO LOWER THOSE PRICES. MEANWHILE, WE MUST COOPERATE INTERNATIONALLY TO MITIGATE THE REAL PROBLEMS AS MUCH AS WE CAN. IF WE CONTINUE THAT COOPERATION, IF WE STAY ALERT, THOSE REAL PROBLEMS WILL NOT BE MADE WORSE BY ANY FREEZING-UP OF THE WORLD'S FINANCIAL MECHANISMS.

THANK YOU.
KISSINGER

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<< END OF DOCUMENT >>

Message Attributes

Automatic Decaptioning: X
Capture Date: 27 JUL 1999
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PETROLEUM PRODUCTION, FOREIGN RELATIONS, US CONGRESSIONAL PRESENTATIONS, PRICES, FOREIGN POLICY POSITION
Control Number: n/a
Copy: SINGLE
Draft Date: 11 JUL 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Authority: n/a
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 JAN 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974STATE150380
Document Source: ADS
Document Unique ID: 00
Drafter: TREAS/OASIA: FLWIDMAN
Enclosure: n/a
Executive Order: N/A
Errors: n/a
Film Number: D740186-0555
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19740789/abbryzqs.tel
Line Count: 542
Locator: TEXT ON-LINE, TEXT ON MICROFILM
Office: ORIGIN TRSE
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 10
Previous Channel Indicators:
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: shawdg
Review Comment: n/a
Review Content Flags:
Review Date: 30 AUG 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <30 AUG 2002 by ThomasVJ>; APPROVED <17 JAN 2003 by shawdg>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: SUBJECTED TO SOME PUBLIC CROSS-EXAMINATION OF MY THINKING AS I ENTER INTO THE NEW DUTIES. I AM PAINFULLY AWARE, HOWEVER, THAT THE OATH TO BE ADMINISTERED LATER TODAY BY SECRETARY SIMON WILL NOT MAKE ME AN INSTANT EXPERT ON ALL ECONOMIC SUBJECTS.
TAGS: ENRG, (BENNETT, JACK F)
To: ABU DHABI
BONN
BRUSSELS
CARACAS

THE HAGUE
JAKARTA
JIDDA
KUWAIT
LAGOS
LONDON
OTTAWA
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Type: TE

Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005